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March 14, 2002

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VIA OVERNIGHT DELIVERY

Idaho Public Utilities Commission
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Re: Case No. GNR-E-02-01

Enclosed for filing please find an original and 7 copies of COMMENTS OF PACIFICORP in the above-referenced matter. Copies have been served as indicated on the attached certificate of service.

Sincerely,

Justin R. Boose

Enclosures

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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

In the Matter of the Investigation of the Continued Reasonableness of Current Size Limitations for PURPA QF Published Rate Eligibility (*i.e.*, 1 MW) and Restriction on Contract Length (*i.e.*, 5 Years).	Comments of PacifiCorp Case No. GNR-E-02-01

PacifiCorp (or the "Company") hereby submits the following comments in response to the Notice of Investigation issued by the Idaho Public Utilities Commission (the "Commission") on February 4, 2002.

A. Summary of Comments

The Company's position is that the Commission should not modify the existing 1 MW threshold for published Qualifying Facility ("QF") avoided cost prices or the standard five-year term of QF contracts. The fundamental assumptions about the future of the wholesale electricity market that led the Commission to arrive at the 1 MW threshold and five-year contract term remain equally valid today and in the foreseeable future. The 1 MW threshold and five-year contract term reflect an appropriate balance between the congressional mandate under the Public Utility Regulatory Policies Act ("PURPA") to promote the development of cogeneration and small power production while at the same time ensuring that ratepayers do not absorb additional costs associated with that development. Reinstituting a 10 MW threshold for surrogate avoided cost ("SAR") prices and/or 20-year levelized QF contracts may result in a subsidy to the QF industry, at the expense of utility ratepayers and in violation of the policies underlying PURPA. Moving to a 20-year contract term without adequate market-based pricing mechanisms may force the utilities to make sustained purchases at a price above their true avoided costs or the prevailing market prices. Raising the threshold for published avoided cost prices to 10 MW prevents an individualized analysis of the true avoided costs associated with those projects, and may make Idaho a magnet for above-market QF generation from neighboring jurisdictions where the threshold is 1 MW.

Conversely, maintaining the current 1 MW threshold and five-year contract term does *not* preclude the development of QF generation resources pursuant to individually negotiated agreements in which the full range of factors (including actual avoided costs, dispatchability, creditworthiness and reliability) may be considered.

To the extent the Commission is inclined to reimplement the 10 MW threshold, 20-year levelized contract terms or both, or to otherwise expand the existing threshold and contract term, PacifiCorp requests that the Commission not do so without also considering the other variables that affect the balance of risks associated with QF contracts. Instead, the Commission should open this proceeding to include a consideration of the full panoply of interrelated QF issues—such as the appropriate avoided cost methodology, market-based pricing mechanisms, fixed versus variable pricing, credit and collateral issues, levelization of prices and related security issues—that affect the risks assumed by a utility and its customers under long-term QF contracts. Such consideration cannot be had in accordance with the Commission's Modified Procedures; therefore, PacifiCorp asks that if the Commission is inclined to alter the status quo, it hold a full administrative hearing to allow reasoned consideration of these issues.

B. The Commission's Decision Should Be Guided by the Principle of Ratepayer Neutrality

A fundamental principle underlying PURPA is that of ratepayer neutrality. Ratepayers should be indifferent as to whether energy is purchased from a QF, generated from utility-owned resources or acquired from other sources. This principle is embodied in the definition of avoided costs:

> "Avoided costs means the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or facilities, such utility would generate itself or purchase from another source." 18 CFR § 292.201(b)(6).

Consistent with the ratepayer neutrality standard, states may not impose avoided cost prices upon a utility that exceed the utility's actual avoided costs. *See, e.g., Conn. Light & Power Co.*, 70 FERC ¶ 61,012 (1995) ("[I]f parties are required by state law or policy to sign contracts that reflect prices for QF sales at wholesale that are in excess of avoided costs, those contracts will be considered void *ab initio*."). Parties aligned with the QF industry will likely argue that the Commission should act to encourage the development of that industry. However, the overriding principle for the Commission to follow in evaluating the threshold for published avoided cost prices and the term for QF contracts is that of ratepayer neutrality.

C. The Commission Should Not Raise the Term for QF Contracts to 20 Years

In deciding to reduce the term of QF contracts from 20 to 5 years, the Commission made the following findings:

> "Significant changes have swept through the electric industry since we last examined the issue of contract length. The FERC has mandated open access to the transmission system, thermal technologies have improved, gas prices are low, there is considerable surplus of energy available in this region resulting in very low spot market prices for electricity and, finally, even the continued existence of PURPA is being called into question. We find that as the industry as a whole continues to transform to a more free market model, we cannot justify obligating utilities to 20-year contracts for PURPA power. As the utilities in this case note, such an obligation does not reflect the manner in which they are currently acquiring power to meet the load; through short-

> term (five years or less) purchases. Consequently, it would be nothing more than an artificial shelter to the QF industry to provide those projects with contract terms not otherwise available in the free market. We can find no justification for insisting that Idaho's investor-owned utilities and their ratepayers assume such an obligation simply to foster one particular segment of an increasingly competitive industry. We find, therefore, that Idaho's investor-owned utilities shall not be required to offer contracts to QFs in excess of five years until further action is taken by this Commission." Order 26576 at 6-7.

Notably, as discussed below, these findings remain largely true today. Open-access transmission linking the supply markets throughout the Western System Coordinating Council has been implemented.[1] Thermal technologies continue to improve. Natural gas prices have returned to historical levels and, combined with normal hydro conditions, have resulted in electricity prices that are relatively low throughout the region. There is legislation presently before Congress that would repeal the mandatory purchase obligation under section 210 of PURPA. *See* Electric Supply and Transmission Act, H.R. 3406, 107th Cong (2001).[2] Finally, 20-year purchase terms are inconsistent with the shorter purchase terms (five years or less) currently used by utilities to meet their supply needs. In sum, because the same concerns that prompted the move away from 20-year levelized agreements are still present, the Commission should maintain the current five-year term.

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[1] The U.S. Supreme Court recently upheld FERC's open access orders and affirmed the breadth of FERC's jurisdiction in the area of transmission. *See New York et al., v. Federal Energy Regulatory Comm'n*, ___ US ___ (2002 WL 331835, March 4, 2002).

[2] Testimony by FERC Chairman Pat Wood in support of H.B. 3406 recognizes that the mandatory purchase obligation is an unnecessary holdover from the precompetitive era:

> "As indicated in the bill's proposed findings, PURPA's 'forced sale' requirement is no longer necessary to promote competition, in light of the availability of open access transmission, and more often serves to distort competitive outcomes. Thus, I agree that Congress should repeal PURPA but 'grandfather' existing PURPA contracts." *See* Testimony of Pat Wood, 2001 WL 26188233 at *9.

1. Wholesale Competition Is a Fundamental Reality of the Electric Industry

In its comments that led to the opening of this docket, the J.R. Simplot Company ("Simplot") stated that "[r]egardless of one's view as to the desirability of competition in the electric industry, it has decidedly not come to Idaho and is very unlikely to do so in the foreseeable future." (Comments of Simplot at 4, Case No IPC-E-01-37.) Because it refers to the retail market and not to the applicable wholesale market, this statement conveys an inaccurate understanding of the electric industry as it relates to the issues at hand.

In the early 1990s, sweeping regulatory changes occurred at the federal level to facilitate competition in the wholesale energy markets, the part of the business in which the QF industry resides. Congress passed the Energy Policy Act of 1992, paving the way for unregulated generators of electricity to enter the market as exempt wholesale generators. In Order 888, FERC implemented mechanisms to require open access on the nation's transmission grids and to allow sellers of electricity to transact according to market-based prices. These regulatory changes, coupled with technology enhancements, led to the proliferation of unregulated power marketers, market indexes, unbundled products, electricity futures and derivatives. Notwithstanding last year's price spikes, the recent demise of Enron and the decreased focus on *retail* deregulation, competition at the *wholesale* level is here to stay.

2. A Five-Year Term Is Consistent with the Company's Portfolio and the Industry Generally

In support of lowering the term of QF contracts to five years, the Commission relied upon evidence that utility power purchases were overwhelmingly moving toward terms of five years or less. This is still the case today. A significant portion of the Company's power purchase needs are being met by purchases of five years or less. The shrinking of the term of power purchases is a direct outgrowth of the advent of competitive wholesale markets. Because competitive markets are alive and well, PacifiCorp projects that it will continue to meet a significant portion of its incremental resource requirements with purchased power on terms of five years or less.

Moreover, short-term purchases are consistent with the company's need for flexible resource options. The Company recently conducted a request for proposals process to procure needed peaking resources for summers 2002-04. The company received 52 proposals from 27 different parties and has secured 400 MW of flexible resources at highly competitive prices. These resources are dispatchable entirely at the Company's option, whereas QF resources are not typically dispatchable. Further, the suppliers were subjected to stringent, ongoing creditworthiness requirements not typically found in QF contracts. Two of the resources are three-year purchase options for the summer months. The third is a 15-year plant lease with purchase/termination options in the third and sixth years.

These resources are representative of the tailored products available in the wholesale market. While forced, long-term purchases of inflexible supply will certainly benefit the QF industry, such purchases are out-of-step with the Company's supply needs and other market alternatives and are inconsistent with PURPA's ratepayer neutrality standard.

3. Current Wholesale Prices Are Below Published Avoided Cost Prices

The Commission need only look to current wholesale market prices for evidence that the competitive wholesale markets are alive and well. The table below compares the prices of various resources available to the Company in Idaho:

Resource Type	**Price (levelized $/MWH)**
PacifiCorp 2002 Non-Fueled Avoided Cost Prices for Idaho	
Five-Year Contract Term	55.73
Twenty-Year Contract Term	73.99
PacifiCorp 2001 Average Price under Existing Idaho QF Contracts	53.19
Mid-Columbia 2002 Average Market Price	28.96

During the market price spikes that occurred last year, the Company experienced a surge in QF proposals for projects seeking to take advantage of high market-based prices. Now that market prices have fallen, QFs are advocating for expanded access to published avoided cost prices. Under these circumstances, a return to 20-year levelized contracts increases the risk that utilities will be forced to make sustained above-market QF purchases, in violation of PURPA's ratepayer neutrality requirement. Recent experience of the California Department of Water Resources confirms that entering into long-term, fixed-price power purchases without adequate market-based price adjustment mechanisms may force the purchaser to make significant above-market purchases. Ultimately, such costs are borne by ratepayers.

D. The Commission Should Not Increase the Threshold for Published QF Avoided Cost Prices to 10 MW

As with the QF contract term, the findings supporting the Commission's decision to reduce the availability of standard QF avoided cost prices from 10 MW to 1 MW still apply:

> "There is a widely held expectation that there will be increasing competition within the electric utility industry. In light of that, we believe it is especially important that the QF industry be able to demonstrate that the energy resources it offers are as cost effective as those that a utility could construct. * * * Thus, ratepayers should not be asked to subsidize the QF industry through the establishment of avoided cost rates that exceed utility costs that would result from an effective least cost planning process. Reducing the threshold correspondingly reduces the risks associated with the published rates being set either too high or too low. * * * We believe that lowering the threshold, along with adopting an IRP-based methodology as discussed later, will help to ensure that a greater number of QF projects are cost effective by market standards before they are acquired by our utilities. By lowering the threshold to 1 MW, we are striking a reasonable balance between encouraging the development of independent, alternative energy technologies with the need to protect ratepayers from paying for resources which have not proven their cost effectiveness." Order No. 25882 at 3-4.

As explained above, competition exists in the regional wholesale market. Accordingly, QF purchases over 1 MW should not be subjected to a static pricing regime over a 20-year period that may force the utility to pay above-market prices. To increase the threshold to 10 MW could result in an artificial subsidy of the QF industry by utility ratepayers. Such an outcome is not consistent with PURPA.

1. The Expansion of Published Prices Prevents Consideration of All Relevant Supply Options in Determining Avoided Costs

If the threshold for published avoided cost prices is raised to 10 MW, a significant percentage of QF generation will be exempted from an individualized avoided cost determination. Such a shift appears to conflict with FERC rulings that all relevant supply sources should be considered in determining avoided costs. *See, e.g., S. Cal. Edison Co. and San Diego Gas & Elec. Co.*, 70 FERC ¶ 61,215 at 61,677 (1995) ("[W]hether a state determines avoided cost administratively or through bidding, a state must in its process reflect prices available from *all sources* able to sell to the utility whose avoided cost is being determined." (emphasis in original)). Indeed, FERC itself noted that in view of the transition to competitive markets, "the need to ensure that the States are using procedures which ensure that QF rates do not exceed avoided cost becomes more critical." *Id.* at 61,675-76.

Published prices, which currently are required to be calculated in accordance with the SAR methodology, do not permit an individualized evaluation of the actual avoided costs associated with the particular resource. For example, FERC regulations for calculating avoided costs require consideration of the QF's peak availability, dispatchability, reliability, ability to coordinate outages, usefulness during system emergencies and actual value to the utility's system. *See* 18 CFR § 292.304(e). Relatedly, the Commission has previously recognized that it is appropriate to consider the effect of transmission constraints on a utility's ability to wheel QF generation to meet load in other areas of its system. *See* Order 25870 at 11-12. Significantly, no adjustments are provided under the SAR methodology for these factors. As indicated by the above discussion of other flexible, less expensive resource options available in the wholesale supply markets, application of the published SAR prices to QFs up to 10 MW will likely cause PacifiCorp's customers to incur higher than necessary costs.

2. Raising the Threshold to 10 MW May Create a Magnet Effect, Attracting Above-Market QF Generation to Idaho

Based on its experience during prior periods in which standard prices were available to QFs up to 10 MW, PacifiCorp is concerned that raising the threshold will again create a magnet effect, attracting above-market generation to Idaho. PURPA permits a QF located in a utility's service area to wheel generation to neighboring areas and subjects the neighboring utility to the same PURPA requirements as the original utility. *See* 18 CFR § 292.203(d). Accordingly, because the threshold in nearly every other jurisdiction in the region is 1 MW, a 10 MW threshold in Idaho may prove attractive to both new and existing QFs located in neighboring states.

Previously, when the 10 MW threshold existed in Idaho, the Company received a number of requests from QFs over 1 MW located in other jurisdictions. *See* Direct Testimony of Roger Weaver in UPL-E-93-3/PPL-E-93-3 at 4-6. The risk for migration to Idaho is particularly acute given low wholesale market prices and the availability of open access to transmission. Such imports may force Idaho utilities and their ratepayers to subsidize a disproportionate share of higher-priced QF resources in the region. Moreover, the wheeling of QF generation may result in inefficient allocation of scarce transmission resources. Like the Commission, PacifiCorp does

> "not believe that PURPA has as a goal the eradication of state boundaries and the creation of a 'value of service' pricing mechanism whereby the utility with the highest avoided costs bids up the price and becomes the recipient of all power available from all cogenerators and small power producers in a given region." (Commission Order No. 15746 at 39, Case No. P-300-12.)

If QFs are truly competitive with utilities and other suppliers, they should be able to survive in the competitive market, without the artificial shelter provided by the published price.

This issue particularly affects PacifiCorp in that a portion of its Idaho QF costs will be included in rate cases in PacifiCorp's other jurisdictions, as a function of the interjurisdictional allocation method. These states may not agree to subsidize above-market QFs, presenting PacifiCorp with additional rate recovery risk.

3. Raising the Threshold to 10 MW May Discourage the Development of Larger, More Efficient QFs

A 10 MW threshold may be contrary to the development of efficient, appropriately sized QF facilities. The Company's experience is that a 10 MW threshold encourages QFs to size facilities at just under 10 MW (*e.g.*, 9.9 MW) or to construct multiple smaller facilities in order to take advantage of the published avoided cost prices. (*See, e.g.*, Application of PacifiCorp at 3, Case No. UPL-E-93-3/PPL-E-93-3.) The imposition of a 10 MW threshold may lead QF developers to forego larger, more economical development in order to take advantage of the published prices.

4. Transaction Costs Associated with Negotiated Avoided Cost Prices Are Not Unreasonably Burdensome upon QFs over 1 MW

PUPRA generally requires utility purchases at the utility's *actual* avoided costs. *See* 18 CFR § 292.202(b)(6). The rationale proffered by FERC in creating an exception for small projects under 100 kW was that the "transaction costs" associated with negotiating individualized prices "would likely render the program uneconomic for this size of qualifying facility." Order No. 69, FERC Regulations Preambles 1977-1981 ¶ 30,128, ¶ 30,848, 45 Fed. Reg. 12,214, 45 Fed. Reg. 24,126 (1980). Originally, FERC had proposed that the threshold be only 10 kW. *Id.* FERC was aware of the concern (shared by PacifiCorp) that "supply characteristics of a particular facility may vary in value from the average rates set forth in the utility's standard rate[.]" *Id.* Although FERC granted states the authority to require published prices for projects above 1 MW, the above authorities make clear that standard prices are appropriate only to the extent that transaction costs would otherwise stifle QF development. This rationale does not apply to QFs over 1 MW.

Transaction costs in negotiating avoided cost prices are not unreasonably burdensome on QFs over 1 MW. Such costs represent a small percentage of overall QF start-up costs, the remainder of which do not vary significantly based on the size of the resource. As previously found by the Commission in lowering the threshold to 1 MW, "the costs of negotiation for projects larger than 1 MW should not be so significant as to render an otherwise viable project infeasible." Order 25882 at 5. This finding remains equally valid today. If anything, the transaction costs associated with negotiated prices will likely be lower today in view of the Commission's established IRP methodology for setting such prices. Given this, no persuasive rationale exists for raising the threshold. To do so would be contrary to the policies set forth in PURPA.

E. If the Commission Is Inclined To Increase the Threshold and/or Contract Term, It Should Expand This Docket To Consider Other Related Issues

As discussed above, PacifiCorp is concerned that reimplementation of 20-year fixed-price, levelized agreements and a 10 MW threshold for published prices may have an adverse effect on retail rates, in violation of PURPA's ratepayer neutrality requirement, and impose additional cost recovery risks on utilities. These risks are largely interconnected with other aspects of QF contracts that are not currently included in the scope of this docket.

For example, the risk that a utility will be forced to pay above market prices under long-term agreements can be addressed in part by the implementation of market-based pricing mechanisms. As one option, the Commission could adopt a 20-year contract term in which the prices are adjusted at five-year intervals, based upon a market price forecast. A second option could involve a "deadband" of a predetermined percentage being placed above and below the contract price. If the actual market price of electricity stays within the deadband, the contract prices would remain unchanged. If the market prices are outside the deadband, the contract prices would automatically be reset to a revised market price forecast, with a new deadband.

Similarly, if the Commission is inclined to revert to a 20 year contract term, it should open this docket to consider the efficacy of price levelization as a means of incenting QF development. Under long-term levelized agreements, above-market prices in initial years may result in payments to QFs that exceed the utility's actual avoided costs, whereas below-market prices in later years may be below the utility's actual avoided costs. Utilities need adequate assurances that QFs will continue to operate during the out of-the-money years, so that both parties obtain the benefits of the bargain underlying such contracts. While the Commission's Order No. 21690 did address the security concerns associated with levelized pricing, it is unclear whether the existing security provisions are adequate to address the risks that Idaho utilities will face if 20-year, levelized contracts are reinstituted.

Additionally, as the utilities will face increased risks associated with QF nonperformance under 20-year contracts, the Commission should consider requiring express creditworthiness and collateral provisions in such contracts. Alternately, these factors could be considered in the calculation of avoided costs. While the FERC regulations indicate that the ability of a QF to perform and the contractual penalties for nonperformance are relevant consideration in calculating avoided costs, *see* Order 69 at ¶ 30,884, the implementation of such provisions is a matter left to state commissions. Uniform creditworthiness and collateral provisions, promulgated by the Commission, will obviate the need for the parties to negotiate individually over such terms.

With respect to the threshold for published avoided cost prices, if the Commission moves to a 10 MW threshold, the Commission should consider the extent to which the SAR methodology may compensate QFs in excess of the utilities actual avoided costs and make Idaho a magnet for out-of-state QFs. A more robust methodology for calculating published avoided cost prices may help mitigate these concerns.

In sum, the above suggestions are not intended to be an exhaustive treatment of the protections necessary to minimize the risks associated with 20 year contracts or a 10 MW threshold. Rather, they are being provided as examples of the need for the Commission to consider all the interrelated issues involved in QF contracts. Accordingly, to the extent the Commission is inclined to alter the status quo in this proceeding, PacifiCorp requests that the Commission open this docket for a full hearing in which the full range of interrelated QF issues—such as market pricing, levelization and security—may be fully considered.

F. Conclusion

For the above reasons, PacifiCorp respectfully requests that the Commission issue an order retaining the current QF contract term and threshold for published avoided cost prices or, in the alternative, that any changes to the current system be addressed in the context of a full hearing dealing with other interrelated QF issues.

DATED: March 14, 2002.

Mary S. Hobson
John M. Eriksson
Justin R. Boose

Of Attorneys for PacifiCorp

CERTIFICATE OF SERVICE

I hereby certify that I served the foregoing COMMENTS OF PACIFICORP on the following named person(s) on the date indicated below by

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DATED: March 14, 2002

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